SYARIKAT PUKIN LADANG KELAPA SAWIT SDN BHD A

v.

KETUA PENGARAH HASIL DALAM NEGERI

HIGH COURT MALAYA, KUALA LUMPUR B
ROHANA YUSUF J
[JUDICIAL REVIEW NO: R2-14-7-2011]
1 NOVEMBER 2011

REVENUE LAW: *Income Tax - Deduction - Whether deductions could* C
be given for advanced rentals paid under 60-year lease agreement -
Whether only annual rental deductible expense for any basis year as
expense 'wholly and exclusively incurred in the production of gross income'
- Whether payment of more rent than what was payable in any basis
year did not make such excess capital expenditure - Whether penalty D
under s. 113(2) Income Tax Act 1967 operates whether or not taxpayer
acted in good faith - Income Tax Act 1967, s. 33(1)(b)

The applicant herein had signed a lease agreement ('the agreement') for lease of certain lands for 60 years at a total rent E
of RM68m. Clause 3.1 of the agreement provided that the annual rental payable under the lease would be RM1,133,333.33. Clause 3.2 of the agreement, however, required the applicant to pay an advanced rental of RM18m upon execution of the agreement, deposit of the duly executed Form 15A, delivery of vacant F
possession of the lands and when the relevant approvals were obtained. The RM18m was paid by the applicant over two basis years. The appellant applied for the RM18m to be considered a deductible expense for the two basis years under s. 33(1)(b) of the Income Tax Act 1967 ('ITA'). The respondent, however, only G
recognised the sum of RM1,133,333.33 as a deductible expense for each basis year. In addition, the respondent imposed a penalty on the applicant under s. 113(2) of the ITA. The applicant's appeal to the Special Commissioners of Income Tax ('SCIT') against the respondent's decisions proved futile. The SCIT further H
ruled that since the applicant had paid more than the average annual rental payable under the agreement, the excess was capital expenditure under s. 39(1)(c) of the ITA as it was paid to obtain the right to lease and to remove caveats on the lands. In its instant appeal against the SCIT's decision by way of case stated, I
the applicant argued that the SCIT was wrong to have restricted

A rental deductible under s. 33(1)(b) of the ITA to only annual rental payable and to exclude payment of advanced rental. The applicant contended that the RM18m was "expenses wholly and exclusively incurred in the production of gross income" under s. 33(1) of the ITA and therefore was a deductible expense.

B

Held (dismissing appeal):

(1) For the production of gross income for the basis period in question, the only required rental to be paid was an annual rental. Advanced rental was not required and hence could not C be construed as expenses wholly and exclusively incurred for the production of gross income for that period *ie*, the basis period of a year of assessment. Since "that period" in s. 33(1)(b) of the ITA meant that basis year, any rental paid over and above the amount that should or ought to be paid D for that year was not captured by that provision. (paras 19, 20 & 22).

(2) The SCIT was correct in applying the phrase rent payable during that period under s. 33 of the ITA to mean the rental E payment which was due during that basis period and not what the lease agreement said. Section 33(1)(b) of the ITA had to be interpreted in light of the principles of deductibility. Although the rentals paid by the applicant were expenses in fact incurred by it in the basis years, a plain reading of s. 33 F of the ITA showed that deductibility was based on the test of whether the "expenses is wholly and exclusively made in the production of gross income" (paras 25 & 34)

(3) The SCIT's construction of cl. 3.2 of the agreement to find G that the RM18m paid by the applicant was to obtain the right to lease and to remove caveat was inaccurate. The lease agreement did not impose any obligation on the applicant to remove caveat but only to pay rental lease. The payment made by the applicant was lease rental in advance. Therefore, H it was not possible for this sum to be treated as capital expenditure. (paras 42, 43 & 44)

(4) Section 113(2) of the ITA operates whether or not there was bad faith on the taxpayer's part. Accordingly, the applicant's I contention that it had acted in good faith due to the differing interpretation of the law could not hold because ignorance of the law was not a defence. (paras 46 & 47)

Case(s) referred to:

British Insulated and Helsby Cables Ltd v. Atherton [1926] AC 205 ***(refd)***

Cape Brandy Syndicate v. The Commissioners of Inland Revenue [1921] 12 TC 358 ***(refd)***

EK Sdn Bhd v. Director General of Inland Revenue [1977] 2 MLJ 264 ***(refd)***

Gallagher v. Jones (Inspector of Taxes) [1994] Ch 107 ***(refd)***

Ketua Pengarah Hasil Dalam Negeri v. Kim Thye & Co [1992] 4 CLJ 2079; [1992] 1 CLJ (Rep) 135 SC ***(refd)***

National Land Finance Co-Operative Society Ltd v. Director General of Inland Revenue [1993] 4 CLJ 339 SC ***(refd)***

Port Elizabeth Electric Tramway Co Ltd v. CIR (1935) 8 SATC 13 ***(refd)***

Robinson v. Scott Bader Co Ltd [1981] (CA) 54 TC 757 ***(refd)***

Stephenson (Inspector of Taxes) v. Payne, Stone, Frazer & Co [1968] WLR 858 ***(refd)***

Strong & Co of Romsey Ltd v. Woodifield [1906] 5 TC 215 ***(refd)***

Vallambrosa Rubber Co Ltd v. Farmer [1910] 5 TC 529 ***(refd)***

Legislation referred to:

Income Tax Act 1967, ss. 2, 33(1), (b), (c), 39(1)(c), 113(1), (2)

For the appellant - Nik Saghir Mohd Noor; M/s Nik Saghir & Ismail

For the respondent - Norhisham Ahmad (Ahmad Ishak Hassan with him); FCs

Reported by Ashok Kumar

JUDGMENT

Rohana Yusuf J:

[1] This is an appeal against the decision of the Special Commissioners of Income Tax ("SCIT") by way of case stated pursuant to para. 34 of sch. 5 to the Income Tax Act 1967 ("ITA").

[2] The salient facts of the case may be summarised as these. The appellant is a company carrying on the business of planting oil palm including processing and production of crude palm oil and palm kernel.

[3] The appellant took a lease of 17 pieces of land with a total area of approximately 7,932 acres ("the lands") under a lease agreement dated 22 February 2002 from Pahangbif Sdn Bhd ("the

A lease agreement"). The lease is for a period of 60 years at a total rental of RM68,000,000. Clause 3.2 of the lease agreement requires the appellant to pay rentals as follows:

(i) Within seven days of execution of the lease agreement, deposit of duly executed From 15A and upon delivery of
B vacant possession; - RM1,392,000

(ii) Upon fulfilment of relevant approvals etc. - RM16,608,000
RM18,000,000

C **[4]** The balance of the rentals are payable yearly in the sums as set out in appendix III to the lease agreement.

[5] The appellant paid a total rental of RM18,000,000 made up of rental payment of RM1,392,000 for the basis year 2002 (YA
D 2002) and RM16,608,6000 for the basis year 2003 (YA 2003). The appellant sought for this total rental of RM18,000,0000 to be treated as deduction under s. 33(1)(b) of ITA.

[6] The Director General of Revenue did not recognise the total amount of RM18,000,000 being rental paid by the appellant for
E the basis years YA 2002 and YA 2003 as deductible expenses under s. 33(1)(b). Instead, the Director General recognised only the amount of RM1,133,333.33 as deductible per year. The amount of RM1,133,333.33 is computed by annualising the total
F rental of RM68,000,000 over a period of 60 years. In other words, the total rental is expressed in yearly terms. In fact, it was also stated in the lease agreement in clause 3.1 that an annual average rental for the lease is RM1,133,333.33.

[7] The appellant appealed before the SCIT on that decision.
G The SCIT deliberated on two main issues raised before them at the appeal. Firstly, whether it was correct in law for the respondent to restrict the deduction of rentals paid in the basis years for YA 2002 and YA 2003 only to the extent of RM1,133,333.33 per year (based on an annualised rental) and not
H the whole of rental actually paid, that is, the sum of RM1,392,000 for YA 2002 and RM16,608,000 for YA 2003.

[8] Secondly, whether the penalty imposed was proper and not excessive in the circumstances of the case. On both issues the
I SCIT decided in favour of the respondent, hence this appeal.

[9] Section 33 of the ITA provides for what amounts to deductible expenses for the basis period. Deductible expenses are expenses that can be deducted from the gross income of a taxpayer. Expenses that can be deducted for the basis year includes all outgoings and expenses which are wholly and exclusively incurred during that basis period in the production of gross income of that period.

[10] For convenience, the relevant part of s. 33(1) of ITA is reproduced below:

> 33(1) Subject to this Act, the adjusted income of a person from a source for the basis period for a year of assessment shall be an amount ascertained by deducting from the gross income of that person from that source for that period all outgoings and expenses **wholly and exclusively incurred during that period** by that person in the production of gross income from that source, including:
>
> (a) ...
>
> (b) **rent payable for that period** (or for any part of that period) by that persons in respect of any land or building or part thereof occupied by him that period for the purpose of producing gross income from that source; (emphasis added)

[11] Learned counsel for the appellant Encik Nik Saghir bin Mohd Noor contended that in arriving at its decision, the SCIT in annualising the rental had caused the word "rent" in s. 33 to be restricted to an average annual rental. He contended, the SCIT erred in arriving at its decision to restrict deductible rental based on annual computation and thereby restricted the word annual rental payable in s. 33(1)(b) to exclude advance rental, which may be payable for that basis year. In so doing the appellant contended, the SCIT had misinterpreted this legal provision for failure to adhere to the often-repeated rule of interpretation of taxing laws enunciated by Rowlatt J in *Cape Brandy Syndicate v. The Commissioners of Inland Revenue* [1921] 12 TC 358. This case was adopted by our Supreme Court in *National Land Finance Co-Operative Society Ltd v. Director General of Inland Revenue* [1993] 4 CLJ 339; [1993] 2 AMR 52. The word 'rent' is widely interpreted under s. 2 of ITA and should include advance rental as well. The appellant further relied on the case *EK Sdn Bhd v. Director General of Inland Revenue* [1977] 2 MLJ 264.

A **[12]** Alternatively, the Appellant contended that rentals paid in the sums of RM1,392,000 in 2002 and RM16,608,000 in 2003 are "expenses wholly and exclusively incurred in the production of gross income" under s. 33(1) ITA. On this basis itself, the rentals paid by the appellant under the lease agreement for the years B 2002 and 2003 totalling to RM18,000,000 are deductible expenses under the same.

[13] It is also the appellant's case that the SCIT had erred in denying the appellant's appeal on the basis that the expenses paid C above the average annual rental was capital expenditure applying s. 39(1)(c). This is because the expenses are not capital expenditure but advance rental.

[14] Learned counsel for revenue, contended that there was no D error or misinterpretation by SCIT as contended by the appellant. The SCIT was correct that under s. 33(1)(b) only annual rental should be recognised. Since the lease term is for a 60-year period and the annual rental as stated under cl. 3.1 is RM1,133,333.33 under s. 33(1)(b), the amount of rental allowed should be based E on annual average lease and not the amount in fact paid under the lease agreement. The SCIT, according to learned counsel had, in arriving at its decision adhered to the principle of strict interpretation of taxing law and hence there is no reason for this court to disturb.

F **[15]** Further to that the revenue argued, based on cl. 3.2 of the lease agreement and the payment stipulated thereunder, and as explained by the witnesses the SCIT found as of fact that the payment of RM18,000,000 made was intended for the purpose of obtaining the right to lease and to remove caveat. These payment, G learned counsel for revenue submitted, are therefore capital expenditure under s. 39(1) of the ITA, and not rental *per se*.

[16] Having appraised with the findings of the SCIT and taken into account the arguments and submissions by learned counsel H for the appellant and learned counsel for the revenue, the issues before this court can be summed up as follows:

(i) Whether rental paid in accordance with the lease agreement, which had in fact been paid, are expenses deductible under I s. 33(1)(b);

(ii) Whether in restricting the allowance for deductible rental to be based on annual rental basis, the SCIT is unnecessarily restricting the meaning of word "rental" in s. 33(1)(b) to exclude advanced rental;

(iii) Whether advanced rental in this case is capital expenses under s. 39 of the ITA.

(iv) Whether the imposition of penalty is correctly made.

Findings

[17] If we were to look at the s. 33 of ITA above, expenses that are deductible includes all outgoings and expenses wholly and exclusively incurred during that basis period. Further, such expenses must be wholly and exclusively incurred for the production of gross income for that year is allowed deduction. As for rental, s. 33(1)(b) clearly states that deductible rental refers to rent payable for that period (or for any part of that period) in respect of any land or building or part thereof occupied by the tax payer in that period for the purpose of producing gross income from that source. Therefore, it may be said that under s. 33, before expenses can be allowed deduction it must fulfil two following elements and they must be read conjunctively:

(i) The expenses must be wholly and exclusively incurred in that basis year; and

(ii) The expenses must be wholly and exclusively incurred in the production of gross income.

[18] In this case, the amount of rental paid under cl. 3.2 of the lease agreement amounts to RM18,000,000, which in fact covers a period of two basis years, namely 2002 and 2003. The SCIT arrived at its conclusion based on the undisputed facts that the lease was for a period of 60 years. The total lease amount of RM68,000,000 was annualised for the total lease period giving an annual rental of RM1,133,333.33 per year. Thus instead of the total sum payable (amount under cl. 3.2 of the lease agreement) in the amount of RM18,000,000 for the two basis year 2002 and 2003, the SCIT upheld the decision of the respondent to restrict the deductible sums to an annualised basis and not the actual paid pursuant to the lease agreement.

[19] Following from the above findings of facts, can we then say that these advance rentals are expenses wholly and exclusively incurred for the basis year and in the production of gross income for that period? In my view, this cannot be so. Even though it is a fact that the sum of RM18,000,000 is contractually payable under the lease agreement they nevertheless represent advance rental. Advance rental cannot be taken in any circumstances to be expenses exclusive and wholly incurred for that basis year because although they are paid in advance, they are actually expenses to be incurred in the future for the production of gross future income. In other words, for the production of the gross income for the basis year in question, the only required rental to be paid is an annual rental. Advanced rental is not required for the purposes of the production of gross income in that basis period and hence cannot be expenses wholly and exclusively for the purpose of the production of gross income in that period.

[20] It must be noted that the words "for that period" is not defined under the ITA but it must necessarily refer to the "basis period of a year of assessment". There is no disagreement between parties on this point.

[21] Learned counsel for the appellant contended that there is no definition of "payable" under the ITA. The appellant agreed on the SCIT resorting to dictionary meaning which is according to Oxford English Dictionary it means "the sum of money, bill etc. That is due to be paid; due, owing, falling due (usually on specified date or to a specified person" Taking it literally, what is payable in this context in the contention of learned counsel for the appellant has to be referred to the provisions under the lease agreement which is provided under cl. 3.2. Thus, the appellant contended, rental payable for that period means rental that the appellant is contractually obliged and payable under the lease agreement for that period.

[22] Conversely, the SCIT interpreted rental payable for that period to mean what rental should or ought to be paid during that period as intended under s. 33. No dispute between parties as to what that period means. It has to the basis year. Since that period means that basis year any rental, which is paid over and above the amount that should or ought to be paid for that year (advance rental) is not captured by this provision.

[23] Thus in my view the decision of the SCIT which finds rental payable in that period cannot refer to what the lease agreement stipulates. It must be read in the context of deductible expenses as envisaged under s. 33. The deductible expenses envisaged under s. 33 are expenses that are wholly and exclusively incurred during that period in the production of gross income.

[24] For the production of gross income in that period the rental that is required is merely an annual rental and cannot therefore include advanced rental. Advance rental would not be expenses that are wholly or exclusively required to produce the gross income for that basis year.

[25] The SCIT therefore is right in applying the phrase rent payable during that period under s. 33 to mean the rental payment, which ought to be due during that basis period and not what the lease agreement says. In a basis period of one year, the deductible income must be confined to the expenses required to produce the gross income for that year.

[26] I am further fortified on this interpretation by the English decision of *Stephenson (Inspector of Taxes) v. Payne, Stone, Frazer & Co* [1968] WLR 858, 1 All ER 524. In that case, the taxpayer was a firm of accountants. It established a service company to provide secretarial and other services to the firm. The charges was agreed to be only minimal. For year 1961, the actual cost of the services was £32,000 but the parties agreed for the charges to be £47,000. This was in excess of £15,000 of the actual cost. This resulted in the reduction of profit of the firm for tax purposes on its first year of business. This £15,000 in excess was to be deducted for sums payable in the future years. It was held in that case that the £15,000 should be disallowed as outgoings in computing the taxpayer's firm profit because it was a misattribution and contrary to the ordinary principles of commercial accounting.

[27] Learned counsel for the applicant submitted that the above case cannot apply and is distinguishable with the present case because the facts and statutory provisions differ. The amount of £47,000 claimed in *Stephenson* was in excess of actual costs of services whereas in the present case the sum of RM18,000,000 were actually paid as rentals and that the annual rental of RM1,133,333.33 was not the actual rental payable for the year. Learned counsel also reminded that the decision in *Stephenson*

A seems to lay emphasis on the principle of commercial accounting whereas the present case dealt with s.33. Similarly, learned counsel argued that in the other English case *Gallagher v. Jones (Inspector of Taxes)* [1994] Ch 107 the reason for non-deductibility is also based on issues of commercial accounting and hence is of no B application to the present case.

[28] I have examined these two English cases, in particular on the issue of advance cost of service and advance rental. In *Stephenson* the judge remarked that the misattribution in that case C is manifestly contrary to ordinary principles of commercial accounting which ultimately distort the true balance of profit of taxpayer. In the same light in my view to allow the deductible rental based on the advance rental as in this case would ultimately affect and distort the true balance sheet and profit of the D taxpayer. This would mean that the total gross income and the total expenditure envisaged by s. 33 would be distorted and this would defeat the whole principle of allowing deductible expenses only in relation to the production of gross income in the basis year. In the same way as the English cases above, it would lead E to misattribution.

[29] In the second case *Gallagher v. Jones (Inspector of Taxes)* [1994] Ch 107, the taxpayer was in the business of hiring narrow boats. The taxpayer entered into leasing agreements with a finance F company for acquisition of three boats upon the terms. For a primary period of 24 months substantial rental was to be made, this was followed by 17 monthly payment and then for the secondary period at annual rental of £5. The taxpayer applied for a deduction of the whole substantial initial rental for the primary G period. On appeal to the special commissioners, it was disallowed on the basis that it was not based on commercial method of accounting and it did not reflect the taxpayer's trading result. This decision was upheld by the Court of Appeal. The Court of Appeal of England agreed that the account did not reflect a true and fair view of the result of the period. H

[30] Learned counsel for the applicant contended that *Gallagher*'s case lays emphasis on the importance of accepted principles of commercial accounting but there was never an issue in the present case. Besides, learned counsel submitted that in *Gallagher*'s case, I the lease was a financial lease and the account must comply with the required standard accounting practice, whereas in the present appeal it involves operating lease and hence is of not application here.

[31] There is no doubt that the tax statute in England is not similar with the provisions of the ITA. However, the principle deduced from these two cases, in my view, concern with the ultimate distortion of the trading result in the basis year.

[32] Looking at the scheme of s. 33 overall, the principle of deductible expenses is inextricably linked to expenses in the basis year and will ultimately distort the trading result of the basis year. For this reason, I have no hesitation to accept the decision of the SCIT on this point.

[33] I now come to the alternative argument by the appellant that, s. 33(1) can apply in the instant appeal on the basis that the actual amount of rentals paid by the appellant were in fact paid in the period and they were therefore expenses wholly and exclusively incurred for that year. Firstly, I do not agree that the general clause of s. 33 should be resorted to because s. 33(1)(b) applies in specific to rental. Secondly, even if s. 33 applies the concept of deductible expenses envisaged by this section generally cannot recognise advance rental as I have earlier explained.

[34] It must be emphasised that s. 33(1)(b) has to be interpreted in the light of the principles of deductibility as I have earlier alluded to in the earlier paragraphs. I can accept the argument that the rentals paid by the appellant were expenses in fact incurred in the basis year. Nevertheless, a plain reading of s. 33 shows that deductibility is based on the test of whether the "expenses is wholly and exclusively made in the production of gross income". The word "wholly" is defined in *Strong & Co of Romsey Ltd v. Woodifield* [1906] 5 TC 215 to exclude expenses which are remotely connected.

[35] What is production of gross income has been defined in *Port Elizabeth Electric Tramway Co Ltd v. CIR* (1935) 8 SATC 13 as expenditure which must be looked to as is performed for the purpose of earning income. Such expenses must be attached to the performance of business operation, performed *bona fide* for earning income. All in all, the test of "wholly and exclusively" have to be based on the facts of each case based on ordinary commercial trading. According to Lord Davey in the case of *Strong v. Woodifield* [1906] AC 448 in order to make a particular disbursement deductible it is not enough that the expenses is made in the course of or connected with trade but it has to be made for purpose of earning profit.

[36] It is clear from the facts of the present case that the total lease paid by the appellant for the years 2002 and 2003 are advance lease made as an obligation under cl. 3.2 of the lease agreement between the appellant and Pahangbif Sdn Bhd. Since the lease paid is in essence advance lease it must necessarily fail the test of it being expenses wholly and exclusively incurred in that year.

[37] This, in the contention of Encik Nik Saghir will lead to an interpretation that will distort the plain meaning of 'rent' in s. 2 of ITA. The definition of rent includes advance rental as decided in *EK Sdn Bhd v. Director General of Inland Revenue* [1977] 2 MLJ 264. With respect, in my view the word "rent" in that case was said to include advance rental, which are assessable income under s. 4 of the ITA. In that case rent was regarded as gross income because the learned judge was of the view that the word rent under s. 2 is not exhaustively defined by virtue of how the definition was drafted, which states that "rent includes ...". It may well be the case that advance rental is gross income.

[38] In the present case we are concern with rent payable in the basis period, which should or should not be treated as expenses wholly and exclusively incurred for the production of gross income. Thus advance rental to my mind cannot fall under this category and this is further reinforced by the observation of Lord Davey in *Strong v. Woodifield* [1906] AC 448 that, in order to make a particular disbursement deductible, it has to be made for purpose of earning profit. Advance rental cannot therefore be construed or be said to be expenses for the purpose of earning profit in any circumstances for that basis year. On these reasons it is my considered view that even applying the test in s. 33(1), advance rental in this case does not meet the necessary test.

Capital Expenditure

[39] I now come to another issue observed by the SCIT. Learned counsel for revenue contended that under cl. 3.2 of the lease agreement the payment made tantamount to capital expenditure under s. 39(1)(c) ITA. This is also one of the deciding order of the SCIT. The SCIT relied on the evidence of AW1 who testified that without paying the whole RM18,000,000 the appellant cannot occupy the land. The SCIT then resorted to

the definition of "capital expense" in *Black's law Dictionary*, which states that it is "an expense made by a business to provide a long term benefit. This capital expense is not deductible but it can be used for depreciation or amortisation". The case of *Robinson v. Scott Bader Co Ltd* [1981] (CA) 54 TC 757 relied upon by SCIT held that the object of expenditure must be looked at, following a subjective test and hence it is a question of fact.

[40] It was found by the SCIT from testimonies before the SCIT that, the appellant agreed to pay this extra RM15,333,333.34 in advance, an extra whopping sum on "only once and for all basis" and as decided in *Vallambrosa Rubber Co Ltd v. Farmer* [1910] 5 TC 529, it is a payment to secure an asset or an advantage for enduring benefit of a trade (see *British Insulated and Helsby Cables Ltd v. Atherton* [1926] AC 205).

[41] Section 39 of ITA is a provision that deals with prohibited deduction. The SCIT in this case had also made a finding that the expenses sought for deductions in this case is declined on the basis that is capital expenditure as provided under s. 39(1)(c) of ITA.

Section 39(1) (c) provides;

> 39. Deductions not allowed
>
> (1) Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment no deduction from the gross income from that source for that period shall be allowed in respect of:
>
> (c) any capital withdrawn or any sum employed or intended to be employed as capital;

[42] A careful examination of cl. 3.2 of the lease agreement relates to removal of caveat or encumbrances on the said land. However the lease agreement does not impose any obligation on the appellant to remove the caveat. The obligation of the appellant under the lease agreement is to pay rental lease. In *British Insulated and Helsby Ltd v. Atherton* [1926] AC 205, a case relied by the SCIT Viscount Cave LJ said:

A But when expenditure is made not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is a very good reason (in the absence of special circumstances leading to the opposite conclusion) for treating such an expenditure as properly attributed not to revenue but to capital.

B

[43] Looking at the lease agreement as the whole, the construction of cl. 3.2 by SCIT to find that the payment made was to obtain the right to lease and to remove caveat, is inaccurate. There is no obligation imposed on the appellant to C remove caveat under the lease agreement and for that reason it cannot therefore be construed as a payment for that purpose. I agree with learned counsel for the appellant that cl. 3.2 (b) (i) only explains that upon receipt of confirmation of actual amount due to LKPT to remove encumbrances. This is only an event that D triggers payment of the advance lease of RM18,000,000. There is nothing to suggest that it is for payment of removing the caveat.

[44] I have also considered the case cited by learned counsel for revenue in *Robinson v. Scott Bader Co Ltd*, [1981] 54 TC, 757. It E was held in that case that the test to be applied is what is the object of making the disbursement and the effect of it. It is clear that the payment made by the appellant here is lease rental payment. It is to all intents and purposes advance rental agreed by parties to be paid in advance. This is because the F RM18,000,000 paid is computed as part of the total rental of RM68,000,000.00 for the 60-year lease. After deducting that amount from the total lease of RM68,000,000, a balance of RM40,000,000 is to be paid in accordance with Schedule 111 of the lease agreement. It is therefore not possible for this sum to G be treated as capital expenditure.

Penalty Imposition

[45] On the issue of penalty, the argument by learned counsel for the appellant was that before s. 113(2) can be invoked, it must H be satisfied that the appellant has:

(i) made an incorrect return by omitting or understating any income;

I (ii) given any incorrect information.

[46] Under s. 113(1) when a person makes incorrect returns or gives incorrect information he can be guilty of an offence and be liable to fine and special penalty double the undercharged tax consequential to that incorrect returns or information. A defence of good faith is provided under s. 113 (1) of ITA. Section 113(2) would operate only if there is no prosecution made under s. 113(1). Thus for the same wrong, that is, making incorrect returns or wrongful information, a person who is not charged under s. 113(1) can be imposed with penalty under s. 113(2). Reading the two provisions quite obviously it is implied this provision operates with or without bad faith. The Supreme Court in *Ketua Pengarah Hasil Dalam Negeri v. Kim Thye & Co* [1992] 4 CLJ 2079; [1992] 1 CLJ (Rep) 135 explained that the objective of assessment of tax contemplates filling of correct returns by taxpayer. Filling incorrect returns attracts a penalty under s. 113(2) of ITA. The court in that case held that this provision vested discretion in the revenue board, a discretion that cannot be exercised at whim and fancy.

[47] The evidence in this case shows that the revenue board became aware of the RM18,000,000 claimed as deduction only upon auditing. Not for the auditing the respondent would not be aware that the deductible rental should be lesser instead. The appellant therefore would be paying less tax. The contention by the appellant that it was made in good faith due to the differing interpretation of the law cannot hold because ignorance of law cannot be a defence.

[48] This country is now adopting a self-assessment regime. Thus in line with the present policy where submission of returns are based on self assessment by tax payer, a tax payer must be mindful of his responsibility to submit correct returns and must necessarily do so upon necessary consultation to ensure correct returns are submitted.

[49] That said, in my view the SCIT had scrutinised the evidence relied upon by the respondent in imposing this penalty, there is no misdirection of law to the facts for which this court should intervene.

[50] In conclusion I hold as follows; s. 33(1)(b) recognise "rental payable" not as provided under the lease agreement but it must be based on the calculation of rental ought to have been incurred

in the basis year based on the principle of expenses wholly and exclusively incurred for the production of gross income in the basis year, thus in coming to its decision that only annual rental is to be recognised under s. 33(1)(b) the SCIT is therefore right in excluding advanced rental, The appeal of the appellant on this ground is therefore dismissed.

[51] The penalty imposed on the appellant was correctly made, no misapplication of law or facts that merits interference by this court. On this reason the appeal of the appellant on this issue is also dismissed.

[52] The SCIT however, had wrongly made a finding that the advance rental of RM18,000,000 cannot be recognised under s. 33 on the ground that it is capital expenses under s. 39 of ITA. From the lease agreement it is clear that the amount of RM18,000,000 is not capital expenses but merely advance rental.

[53] In the circumstances, I hereby dismiss the appeal of the appellant and I make no order as to costs.